Construction Law



Published by the Construction Law Section of the Washington State Bar Association

Volume 40 Spring 2011 Number 1

Chair's Report

by Rob Crick

Welcome to the Construction Law Section Newsletter. The Section includes more than 600 lawyers whose practice to a substantial degree involves advising and assisting construction industry participants. I am honored to serve as the Chair of the Section again this year (until June as you will see later herein).

The Section's principal mission is to provide educational opportunities for our members on construction-related topics, primarily regarding court decisions and legislative action. In that regard, during the last year the Section presented an all-day CLE on Public Works Contracting in June. We also held a Fall Forum in which party representatives provided an overview and status of the *Williams v. Athletic Field, Inc.* case, and, following that, there was a discussion of potential legislation that may arise because of the judicial decisions. Our CLEs and forums are of the highest quality, are well attended, and provide financial support for the Section.

In addition, this newsletter, edited by Larry Vance, provides up-to-the-minute analyses of the latest construction-related cases and legislative happenings. For example, the above-referenced case, *Williams v. Athletic Field, Inc.*, continues to generate a substantial amount of attention in the industry. There is an article on the case in this newsletter.

Also, during the last year the Section prepared two Model Residential Construction Contracts for use by industry participants. The two model contracts are: 1) Lump

Sum Contract, where the owner agrees to pay the contractor a specified amount for completing the scope of work without requiring a detailed cost breakdown; and 2) Cost Plus Contract, where the owner pays for the actual cost of the work, plus a fee for the contractor's services.

The Section developed these contracts as a public service to the construction industry and its residential consumers and contractors. The contracts were two years in the preparation and have undergone extensive review. They have been approved for posting on the WSBA website by the Board of Governors and are available for download and use from the Section's website. They may be modified as needed to fit individual circumstances.

During the Fall Forum, the Section also approved modifications to the Section's Bylaws. The amended Bylaws are posted on the Section's website. One of those modifications is that from here forward, the Annual Mid-Year CLE will serve as the Section's Annual Meeting and Election of Officers. Thus, all who would have completed their terms in October as in past years (me included) were extended to this coming June. Then in June there will be three (3) openings for election to the Section's Board of Trustees. And from here forward all elections will be in June at the annual Mid-Year CLE. If you are interested in running for election, please contact me or one of the officers. The Section Board of Trustees is composed of lawyers who represent continued on next page

In This Issue

Chair's Report1	Lien Claims/Necessity
Supreme Court Plurality Scraps the "Economic Loss Rule" in Favor of the "Independent Duty Doctrine"2	Property/Necessity of and Non-Judicial Fore Foreclosure Proceedin Contractor Registration Provision 18.27.040(3) Serve Contractor/Fail Jurisdiction over Cont
In Recent Washington Insurance Case: Appellate Court Creates New Law5	
Court Rejects First in Time, First in Right Rule for Claims Against Contractor's Registration Bond6	
Sprague v. Safeco Ins. Co. of America6	Contractor Partially V
Fall Forum: Packed House Considers Williams v. Athletic Field Inc.	,

Lien Claims/Necessity of "Improvement" to Real
Property/Necessity of Contract/Deeds of Trust
and Non-Judicial Foreclosure Proceedings v. Lien
Foreclosure Proceedings
e e

CHAIR'S REPORT from previous page

both public and private entities. In fact, we attempt to maintain an equal balance in that regard. We further invite members of minority groups, all religious affiliations, and all genders to join in the Section leadership.

The Section has been blessed by having strong leadership since its inception. All of us serving on the governing council are volunteers, come from all across the state and from firms large and not-so large. Our meetings are open to any Section member, and we welcome new volunteers to the service of the Section.

We are already hard at work preparing for the upcoming Mid-Year CLE. This year the topic is working with experts. The speakers will primarily be individuals who serve as experts in construction claims and disputes; thus the title "Hear from the Experts." Topics will include reading schedules to show delay or not, understanding construction cost accounting, reading construction drawings, admissibility issues that arise with reconstruction evidence, reviewing graphics and 3D modeling, plus the annual case and legislative review, and an hour of the ethics of working with experts. The Mid-Year CLE will be held on June 10 at the WSBA CLE Center. Please mark your calendars and plan to attend.

Enjoy the Newsletter and feel free to contact me any time regarding Section business.

> Thanks, Rob Crick

Supreme Court Plurality Scraps the "Economic Loss Rule" in Favor of the "Independent Duty Doctrine"

by John H. Guin - Law Office of John H. Guin, PLLC -Spokane, Washington

In two separate decisions issued on the same day, a divided Washington Supreme Court decided that confusion over the application and extent of the "economic loss rule" required that the concept be scrapped in favor of an equally confusing "independent duty doctrine." In one case, the Supreme Court held that a party could sue both in contract and in tort if both contract and tort duties exist and are breached. Eastwood v. Horse Harbor Foundation, *Inc.*, __ Wn.2d __, 241 P.3d 1256 (2010). In the other case, the Supreme Court held that an engineer could be sued in tort for financial losses suffered by a non-party to the engineer's contract. Affiliated FM Ins. Co. v. LTK Consulting Services, Inc., __ Wn.2d __, 243 P.3d 521 (2010).

continued on next page

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Supreme Court Plurality Scraps the "Economic Loss Rule" in Favor of the "Independent Duty Doctrine" from previous page

Eastwood v. Horse Harbor Foundation, Inc., 241 P.3d 1256 (2010):

In Eastwood v. Horse Harbor, a lessee of property (Horse Harbor) caused damage to the lessor's (Eastwood) property by failing to adequately maintain the property. Eastwood sued Horse Harbor for breach of the written lease, which required that Horse Harbor maintain the property in good condition. At the same time, Eastwood also sued Horse Harbor and its representatives in tort for the commission of waste. Eastwood prevailed at trial on its claims for breach of the lease and for waste. Interestingly, none of the parties raised the issue of economic loss at trial or on appeal to the Court of Appeals. Instead, the Court of Appeals, "on its own motion and without argument," applied the economic loss rule and limited Eastwood's claims "to recovery only for breach of lease." Eastwood, 241 P.3d at 1260.

In overturning the Court of Appeals, the lead opinion (signed by only three justices) concluded that the concept of "economic loss" has caused confusion in its application by lower courts because the type of damage is not necessarily determinative of whether a tort remedy is available:

The term "economic loss rule" has proved to be a misnomer. It gives the impression that this is a rule of general application and any time there is an economic loss, there can never be recovery in tort. This impression is too broad for two reasons. First, it pulls too many types of injuries into its orbit. When a contractual relationship exists between the parties, any harm arising from that relationship can be deemed an economic loss for which the law of tort never provides a remedy....

Second, and most importantly, the broad application of the economic loss rule does not accord with our cases. Economic losses are sometimes recoverable in tort, even if they arise from contractual relationships.

Id. at 1261. Instead, the lead opinion held that courts must engage in a case-by-case analysis to determine whether an independent tort duty exists, which is a question of law that requires a court to consider logic, common sense, justice, policy, and precedent:

Where this court has stated that the economic loss rule applies, what we have meant is that considerations of common sense, justice, policy, and precedent in a particular set of circumstances led us to the legal conclusion that the defendant did not owe a duty. When no independent tort duty exists, tort does not provide a remedy.

Id. at 1262. Based on this analysis, the lead opinion concluded that the duty to not commit waste is a duty that arises independently of any contract. Therefore, "an aggrieved lessor may pursue damages concurrently under theories of tort and breach of lease." *Id.* at 1267.

In reaching this conclusion, the lead opinion acknowledged that a bright-line rule that clearly separates injuries between economic losses, personal injury, and property damage could be helpful; however, the opinion states that such a rule can create confusion over where "economic loss ends and property damage begins." *Id.* at 1265.

Two separate concurring opinions were issued as well. In one opinion, two justices argued that the discussion and abandonment of the economic loss rule was unnecessary because: (a) waste is a statutory remedy that is available irrespective of contract remedies; and (b) there was clearly injury to Eastwood's property, making the economic loss rule inapplicable. *Id.* at 1268. In the other concurring opinion, four justices argued that the "independent duty doctrine" is not so much a rule as a function of the court to determine when, as a matter of law, tort duties exist. The opinion concurs that the "economic loss" concept is problematic and that the independent duty rule is more appropriate. *Id*. at 1276. However, the opinion emphasizes that the use of this analysis has generally been limited to actions involving damages to products sold or to construction and sale of real property and further cautions whether it should be applied "outside of these limited circumstances." Id. at 1275.

Affiliated FM Ins. Co. v. LTK Consulting Services, Inc., 243 P.3d 521 (2010):

Affiliated v. LTK Consulting is a case arising out of a fire that occurred on the Seattle Monorail during operation of the system. Factually, the City of Seattle had a written concession agreement with Seattle Monorail (SMS), which gave SMS the exclusive operation of the system. Under the agreement, SMS had responsibility for emergency maintenance, but the City had the responsibility for general maintenance and repair. As part of the City's maintenance responsibilities, the City entered into a contract with LTK to examine the system and to recommend repairs. "SMS was not a party to the contract." Affiliated, 243 P.3d at 524.

In May 2004, a fire started beneath one of the trains while in operation, damaging the system and creating a safety hazard for passengers. The cause of the fire was discovered to be an electrical problem. SMS's insurance carrier paid out more than \$3.2 million to SMS for losses consisting of repair costs and business interruption. SMS's carrier then commenced an action against LTK, alleging negligence in regard to LTK's engineering services. The action was removed to federal court, where the trial court granted LTK's summary judgment motion on the basis that the economic loss rule barred recovery because the losses "stemmed from business interruptions and SMS's contractual obligations to repair the" system. *Id.* at 524. On appeal,

Supreme Court Plurality Scraps the "Economic Loss Rule" in Favor of the "Independent Duty Doctrine" from previous page

the Ninth Circuit Court of Appeals certified the following question to the Washington Supreme Court:

May party A (here, SMS, whose rights are asserted in subrogation by AFM), who has a contractual right to operate commercially and extensively on property owned by non-party B (here, the City of Seattle), sue party C (here, LTK) in tort for damage to that property, when A (SMS) and C (LTK) are not in privity of contract?

Id. at 525.

In responding to the certified question, the lead opinion (signed by only two justices) relied heavily on the *Eastwood* decision, stating that "the court's task is not to superficially classify the plaintiff's injury as economic or noneconomic. Rather, the court must apply the principle of Washington law that is best termed the independent duty doctrine." *Affiliated*, 243 P.3d at 526. The lead opinion then explained the parameters of the court's analysis under the independent duty doctrine. In doing so, the opinion identified three main issues for consideration of whether an independent duty exists that gives rise to tort liability: (a) the existence of a duty; (b) the measure of the duty; and (c) the scope of the duty. *Id*.

With regard to determining the existence of a duty, the lead opinion held that it is a question of law for the court. The court is to balance the varying interests at stake with considerations of logic, common sense, justice, policy, and precedence. Id. In this case, the lead opinion determined that the primary interest raised was the interest in safety of persons and property from physical injury, which is an interest "that the law of torts protects vigorously." *Id*. at 528. In addition, the lead opinion determined that the engineer was in the best position to prevent the harm because of their position of control. Finally, the lead opinion considered that the potential for tort liability may likely force engineers to avoid unreasonable conduct and cause them to mitigate the risks of negligent conduct. *Id*. Therefore, the lead opinion concluded that LTK owed an independent duty of care to SMS.

With regard to the measure of the duty of care, the lead opinion determined that the engineer's duty should be measured by "what a reasonably prudent engineer would do." The lead opinion declined to impose a higher duty of care because such a measure "would make engineers insurers and expose them to an intolerably high risk of liability." *Id.* at 529.

With regard to scope, "a duty of care encompasses classes of harm and classes of persons." *Id.* The considerations for determining scope are similar to the considerations for determining whether a duty exists. *Id.* With regard to class of harm, the lead opinion held that safety risks of physical

damage to property is within the class of harms and that the safety risk posed by the fire in this case was sufficient to fall within the scope of the engineer's duty. *Id.* at 529-30. With regard to class of persons, the lead opinion held that the duty extends to persons with an interest in the property and that SMS had a legally protected interest by virtue of its concession agreement with the City. *Id.* at 530-31.

In the end, the lead opinion held that SMS could sue LTK for negligence after applying the independent duty doctrine to the facts of the case. *Id.* at 532.

In a concurring opinion, four justices agreed with the result but did not believe that the detailed analysis under the independent duty doctrine was necessary. Rather, the concurring justices concluded that "[t]his case is ... a straightforward claim of professional negligence." *Id*.

In a concurring / dissenting opinion, three justices criticized the lead opinion's analysis as "more than a course correction." They described the analysis as "a wholesale rejection of our prior cases." *Id.* at 533. The opinion describes the analysis as completely unnecessary because the economic loss rule was not implicated in any way, as there were no contractual remedies available to SMS. *Id.* at 534-40.

Summary

The Supreme Court's attempt to dispose of the confusion created by the "economic loss rule" appears to have traded one uncertainty for another. The lack of a clear majority opinion will likely lead to additional wrangling over the extent and nature of the independent duty doctrine.

Because both *Eastwood* and *Affiliated* are plurality opinions, each opinion will need to be further dissected to determine the exact points that have majority support. The summary above focuses mostly on the content of the lead opinions, only because the concurring opinions tie back to the statements in the lead opinion to provide concurrence or disagreement. In the end, there are three significant opinions that appear to have a majority:

- (a) the independent duty doctrine or rule is a more appropriate analysis than the economic loss rule when determining if a claim is available under a tort theory (*Eastwood*, 241 P.3d at 1261 (Fairhurst, J., opinion); *id.* at 1276 (Chambers, J., concurring));
- (b) whether a tort duty exists is a question of law for the court, based on considerations of common sense, justice, policy, and precedent (*id.* at 1262 (Fairhurst, J., opinion); *id.* at 1275 (Chambers, J., concurring)); and
- (c) tort duties may exist independently of contractual duties and recovery may be available under a tort theory regardless of the existence of a contract (*id.* at 1264 (Fairhurst, J., opinion); *id.* at 1276 (Chambers, J., concurring)).

Supreme Court Plurality Scraps the "Economic Loss Rule" in Favor of the "Independent Duty Doctrine" from previous page

In light of the plurality opinions, the detailed analysis over when a tort duty exists and the scope of that tort duty will undoubtedly create as much confusion as the economic loss rule. This is particularly true because prior appellate decisions dealing with the concept of economic loss (such as *Berschauer/Phillips Constr. Co. v. Seattle Sch. Dist. No.* 1, 124 Wn.2d 816, 827, 881 P.2d 986 (1994) and *Stuart v. Coldwell Banker Commercial Group, Inc.*, 109 Wn.2d 406, 745 P.2d 1284 (1987)) do not appear to have been overturned in their ultimate holdings and appear to be good law on the ultimate question of whether particular types of causes of action exist in tort. Rather, their analysis as it relates to economic loss is no longer the appropriate analysis.

In the end, the lead opinions' decisions in *Affiliated* and *Eastwood* are an attempt to focus the analysis back on to the facts and circumstances of an individual case, rather than allowing a bright-line rule (which was never that bright) as the determining factor. This is just another scene from the age-old debate about whether a bright-line rule or case-by-case analysis is the better model for civil justice. In any event, these opinions will place a greater burden on the trial lawyers to better articulate the factual bases for their clients' claims as well as the policy considerations affecting their clients' claims, so that they may better educate the trial courts who will have to wade through these difficult questions.

In Recent Washington Insurance Case: Appellate Court Creates New Law

by Richard D. Campbell – Campbell & Bissell, PLLC – Spokane, Washington

On October 19, 2010, Division Two of the Washington State Court of Appeals issued a decision in Vision One, LLC v. Philadelphia Indemnity Insurance Company involving construction of a condominium complex in Tacoma. Vision is a developer who began building a condominium complex in Tacoma in 2005. Shortly thereafter, a contractor poured a concrete slab and the shoring structure collapsed, causing significant damage and delays to the project. Vision filed a claim with its insurance company, Philadelphia, to cover the loss. Philadelphia hired a structural engineer to examine the shoring design drawings. The engineer determined the design was adequate to support the weight of the concrete but "at best, this shoring design is marginal and it doesn't allow for any inadequacies in the shoring installation." The structural engineer concluded the collapse was partially caused by flaws in the shoring installation, "including: missing cross-braces, overextended tubes, tilting shoring towers, and inadequately supported base plates placed on unlevel surfaces."

Vision had an "all risk" policy that excluded loss caused by defective design or faulty workmanship. Regardless, Vision submitted a claim relying on certain language in the faulty workmanship exclusion which provided coverage for "resulting loss": "[I]f loss by any of the Covered Causes of Loss results, we will pay for that resulting loss." Philadelphia denied Vision's claim, stating the damage to the construction project was caused by the defective design and faulty workmanship of the shoring, and the resulting loss provision did not apply because there was no separate and independent loss that caused the claimed damage.

Following denial of the claim, Vision settled with the contractor and shoring equipment supplier which released the supplier from any further liability. Vision then sued the insurance company in March 2006 for breach of contract and bad faith. Philadelphia moved to dismiss Vision's breach of contract claims, arguing that the settlement breached the insurance contract by impairing Philadelphia's potential recovery rights against the supplier. In a pre-trial hearing, the court ruled the collapse of the concrete slab was covered under the "resulting loss" exception to faulty workmanship exclusion. At trial, the jury determined the concrete collapse caused \$251,023 in repair and reconstruction expenses and \$724,605 in delay damages. The jury also found that Philadelphia acted in bad faith and committed five CPA violations, causing \$178,728 in damages to Vision. The trial court awarded Vision a principle judgment of \$1,148,428, an additional \$50,000 for the five CPA violations, and \$1,997,818 for attorney fees and costs.

Philadelphia appealed. At issue on appeal was whether Vision impaired the insurance company's recovery rights by settling with a subcontractor and whether the trial court should not have imposed liability under the resulting loss exception to the faulty workmanship provision.

1. Impairment of Recovery Rights

Regarding the impairment of recovery rights claim, the court of appeals framed the issue as whether the insurance company may enforce the policy's impairment of recovery rights provision against an insured <u>after</u> denying the claim. No Washington cases have addressed the issue before. After considering cases from other jurisdictions, the Court of Appeals held that the insurance company could not deny the insured's claim and then argue the insured breached the policy by impairing the insurer's recovery rights through settlement.

This is new law in Washington. Now, if an insurer denies a claim, the insured is free to settle with a potentially liable party and not risk breaching the insuring agreement.

2. Resulting Loss Ruling

Regarding the resulting loss ruling, Philadelphia argued the trial court erred by finding the concrete slab continued on next page

IN RECENT WASHINGTON INSURANCE CASE: APPELLATE COURT CREATES NEW LAW from previous page

collapse was not a "resulting loss" under the resulting loss exception to the faulty workmanship exclusion. The appellate court explained that resulting loss clauses apply when an excluded peril causes a separate and independent covered peril. Damage resulting from the covered peril is then covered under the resulting loss provision, while damage resulting from the initial excluded peril remains uncovered.

The appellate court reasoned that if the faulty work-manship caused the shoring and concrete slab to collapse, faulty workmanship was the initial excluded peril and the collapse was the loss. If so, the court opined, there was no independent covered peril (e.g., a fire) that caused a covered resulting loss and the collapse resulted directly from the initial excluded peril of faulty workmanship, and loss resulting directly from the initial excluded peril remains uncovered. Therefore, the court held that the concrete slab collapse was not covered under the resulting loss exception to the faulty workmanship exclusion in Vision's insurance contract.

The court's decision means there will be no coverage on remand after a new trial if the jury determines that faulty workmanship caused the collapse, because the resulting loss exception would not apply. The collapse would be covered only if the jury determines that faulty equipment caused the collapse, or that multiple perils caused the collapse and faulty equipment was the efficient proximate cause.

Court Rejects First in Time, First in Right Rule for Claims Against Contractor's Registration Bond

by Richard D. Campbell – Campbell & Bissell, PLLC – Spokane, Washington

The Registration of Contractors Act, chapter 18.27 RCW, requires contractors to register with the Department of Labor and Industries (L&I) and post either a surety bond or an assigned savings account. RCW 18.27.040 allows certain aggrieved parties to bring suit against the contractor and/or the cash security posted with L&I or the Surety to recover on the bond. Said statute also delineates the priority of recovery where there are different classes of claimants (i.e., laborers, residential homeowners, material suppliers, etc.). Where, however, the contractor has posted a cash security (assigned savings account), both the Contractor Registration Act and certain WAC provisions promulgated by the Department of Labor and Industries basically provide for a race to judgment basis for disbursement of the cash

security. The Act does not, however, address what should occur when two claimants of the same class or priority have actions pending at the same time against a surety bond and subsequently obtain judgments against the bond.

In *Hosea v. Griffin,* 156 Wn. App. 263; 232 P.3d 576 (2010), two homeowners filed separate suits against a specialty contractor for breach of contract. Homeowner 1 obtained a \$16,828.00 judgment against the contractor on February 28, 2008. Shortly after Homeowner 1 obtained the judgment, both homeowners' cases were consolidated by the parties for the purposes of reaching the bond proceeds. Several months later, Homeowner 2 obtained a \$43,638.00 judgment against the contractor on August 13, 2008. Prior to Homeowner 2 obtaining a judgment, Homeowner 1 successfully moved the court for an order disbursing the entire amount of the bond to Homeowner 1. Homeowner 2 appealed.

On appeal, the court determined that the legislature did not intend for a first in time, first in right or "first to judgment" rule to apply to the disbursement of surety bond proceeds when claimants are the same class or priority are pending at the same time. Rather, the court held that "as a general rule, where multiple claimants in the same priority tier ... have actions commenced and pending against a surety bond, the claimants are entitled to a pro rata distribution of the surety bond proceeds."

Sprague v. Safeco Ins. Co. of America Washington State Court of Appeals No. 63933-1-1 (November 1, 2010)

by Ryan D. Yahne – Winston & Cashatt – Spokane, Washington

The Court of Appeals for Division I recently published an opinion regarding whether resulting damage caused by an excluded peril under a homeowner's all risk insurance policy can still be covered under an ensuing loss clause.

Max and Krista Sprague (collectively "Sprague") purchased a home in 1987 and insured with Safeco Insurance Company ("Safeco"). Between 1995 and 1996, the Spragues installed decks at the home supported by six "fin walls" covered with Dryvit, an exterior insulating and finishing system. Sprague discovered decay in these fin walls in March of 2008 and filed a claim with Safeco.

Safeco's independent expert investigated the claim and found that the decayed wood posts in each of the six supporting piers resulted in substantial impairment of the structural integrity and were in a state of "eminent collapse." Safeco's expert attributed the decayed wood framing to a combination of inadequate flashing between the deck beams and the deck piers, possible inadequate flashing between the deck guardrails and the deck piers,

Sprague v. Safeco Ins. Co. of America from previous page

and inadequate ventilation of the deck piers. Sprague's policy through Safeco, however, specifically excluded damage as a result of construction defects and dry rot. However, the policy specifically mentioned "any ensuing loss not excluded is covered."

The Court noted, by way of example, that an ensuing loss exception preserved coverage from water leaks caused by faulty construction, despite the exclusion for construction defects. However, this type of ensuing loss can be excluded if the specific damage, for example mold, is also specifically excluded. In other words, the ensuing loss provision exception does not operate if the ensuing loss itself is not a covered loss. The Court clearly noted that the Safeco policy would not cover faulty construction and rot but may cover the "ensuing loss caused by such faulty construction and rot." Safeco's expert testified that the damage to the fin walls had placed the decks in a state of "eminent collapse," and if the ensuing loss of collapse was not excluded, it would be covered under the policy.

The Court said that the meaning of "collapse" as used in insurance policies had not been specifically defined in Washington. The Court noted that in *Mercer Place Condominium Association v. State Farm Fire & Cas. Co.*, 104 Wn. App. 597, 17 P.3d 626 (2000), the court stated that "a growing majority of jurisdictions have assigned the more liberal standard, 'substantial impairment of structural integrity,' to the use of 'collapse' in insurance policies, as opposed to the minority view, which requires that the structure actually fall down." The *Mercer* court stated that collapse in this scenario meant "substantial impairment of structural integrity."

Comparing *Mercer* to the situation at hand, the Court noted that Safeco's own expert determined that the decks had a "substantial impairment of structural integrity" and that they were "in a state of eminent collapse." Not surprisingly, the Court went on to hold that, based solely on Safeco's own expert's definition, the building was in a state of eminent collapse, there was substantial impairment of structural integrity of the building, and, therefore, collapse was established in the present case, and this was a covered loss under the ensuing loss provision.

This case appears to take another step forward in adopting a uniform definition of the term "collapse" in insurance policy interpretation in Washington. The Court, while clearly construing all facts and reasonable inferences in favor of the insured, used a gap in the exclusions of this particular policy to grant relief to the homeowner. In the future, it is foreseeable that such an interpretation may apply in other areas, most notably in losses caused by "work" of a contractor. Such instances would arguably be excluded under the "your work" exception, but the *Sprague* holding could be used to expand coverage in areas based on ensuing losses not specifically excluded.

FALL FORUM Packed House Considers Williams v. Athletic Field, Inc.

by Robert L. Olson – Schiffrin Olson Schlemlein & Hopkins, P.L.L.C. – Seattle, Washington

The Construction Law Section conducted its annual Fall Forum at the offices of K&L Gates in downtown Seattle on October 19, 2010. Approximately 60 people packed the conference room to hear more about the case of *Williams v.* Athletic Field, Inc., 155 Wash. App. 434, 228 P.3d 1297 (2010), decided in April of last year and reported in the Fall 2010 issue of this Newsletter. See "Sending Shockwaves Through the Construction Bar" at page 7. Attorneys Kirk Wines, representing Athletic Field, and Klaus Otto Snyder, representing Williams, each made short presentations regarding their perspectives on the case and recounted some of the procedural history not reported in the court's decision. They were followed by attorney Mark Grace representing the Associated General Contractors, which filed an amicus brief in support of the petition for review filed by Athletic Field with the Washington Supreme Court. Mark provided an overview of the *amicus* brief and the position of the AGC in urging the Supreme Court to accept review and reverse the decision of Division III of the Court of Appeals.

Rick Slunaker, the Government Affairs Director for the AGC and its lobbyist, then spoke briefly about the AGC's perspective. He said the AGC believes the legislature intended to simplify the lien claim statute by allowing the use of a simple form and that the *Williams* case ignored that legislative intent. He could not say for certain at that time whether the AGC intended to present any legislation to the 2011 session of the Washington legislature.

Kathryn Leathers, from the WSBA, then delivered an interesting presentation on the procedure and process required for a section of the Bar Association to support a bill presented to the legislature. The process is complicated and not easily summarized. In essence, before our Council can represent that a bill has Section support or the support of the WSBA, it must, at a minimum, obtain approval of 75% of the Council.

Tom Wolfendale, the Chair Elect of the Section, then solicited member input on what position, if any, the Council and the Section should take on any legislative proposals that may be put forth to deal with the *Williams* case or any other proposed piece of legislation.

Update on Williams

Following the Forum, the Supreme Court granted the petition for review and accepted the *Williams* case. It is likely to schedule oral argument on the *Williams* case dur-

PACKED HOUSE CONSIDERS WILLIAMS v. ATHLETIC FIELD, INC. from previous page

ing the spring term which will be held in May and June of this year. Stay tuned for further developments.

The AGC has since decided to propose legislation to the 2011 session of the Washington legislature to deal with the *Williams* case. In essence, it proposes amending RCW 60.04.091 to clarify both the signature and acknowledgment requirements and the "safe haven" form set forth in that statute.

The Section is planning to devote a part of its annual Construction Law Seminar to the *Williams* case. That seminar will be held on June 10, 2011. Further details on legislative action on the *Williams* case, if any, and a review of the oral argument in the Supreme Court, if done, will be provided at that time.

Lien Claims/Necessity of "Improvement" to Real Property/ Necessity of Contract/Deeds of Trust and Non-Judicial Foreclosure Proceedings v. Lien Foreclosure Proceedings

(Colorado Structures v. Western Development Partners, ___ Wn. App. ___ (Division 3 Court of Appeals, 2011)

by Larry Vance – Winston & Cashatt – Spokane, Washington

Once again the Court of Appeals (Division 3) reminds us that there are many hoops that a lien claimant must jump through before it can establish its lien rights; and that deeds of trust recorded on the real property prior to the contractor's first date of furnishing labor or materials can significantly impact the lien claimants' lien rights. In the case of *Colorado Structures v. Western Development Partners*, the lien claimant (Colorado Structures) was held to have several deficiencies in its lien claims on a mall project.

Factual Background

Colorado Structures (CSI) is a major contractor on projects throughout the western United States. In the spring of 2007, CSI was approached by Western Development Partners (WDP) to develop (expand) an existing mall in Walla Walla, Washington. An engineering report, apparently provided to CSI prior to bidding on the project, seemed to suggest that the property might have groundwater issues. Presence of ground water would be a factor which could seriously potentially impact CSI's proposals. Accordingly, CSI decided to have test pits dug on the property in order

to determine the depth of the groundwater. CSI hired a subcontractor to dig test pits on August 7, 2007. These test pits were filled in the following day, and CSI did not submit a bill for this work (but CSI did subsequently maintain that this work was part of its preconstruction costs). **These test pits became the focus of several legal issues concerning the validity and priority of the lien rights of CSI.**

Later in the month of August 2007, a local development company by the name of Blue Mountain Plaza, LLC (BMP) apparently purchased WDP's right to purchase the mall from another developer. Eventually, CSI entered into several separate contracts with BMP for various aspects of work on the mall. The first contract that CSI entered into with BMP was for site construction and was entered into on November 15, 2007. Separate contracts for separate stores were later entered into between CSI and BMP in April and May of 2008.

Equity Funding LLC (Equity) loaned BMP \$10.5 million to purchase the mall from another developer (Meyer), who had obtained an equity interest in the property. This loan was closed on February 7, 2008. Equity's deed of trust was filed the next day (February 8, 2008). A second deed of trust was filed by WDP on February 11, 2008. Prior to the sale, Meyer had refused to allow CSI access to the mall site in order to begin construction.

When CSI subsequently began work on the mall, BMP failed to make regular payments to CSI towards construction cost, but assured CSI that financing was imminent. Financing, however, never materialized, and CSI filed liens and amended liens in June, July and August 2008. All of these liens, however, reflected a work starting date of February 28, 2008 (after the two (2) deeds of trust had both been recorded).

CSI suspended work on the project on December 3, 2008. One week later, CSI amended its liens to reflect a work start date of August 7, 2007 (the date that its subcontractor dug the test pits). It is not clear from the Court's opinion, but apparently WDP (the holder of the second deed of trust) commenced nonjudicial foreclosure proceedings and apparently sent notice of the trustee sale to all parties with an interest in the project, including specifically CSI. "Meanwhile, back at the ranch," CSI filed a complaint to foreclose its liens on January 22, 2009. CSI did not, however, take any action to stay the trustee sale. WDP sold and assigned its rights to another company, Walla Walla Holdings, LLC (WWH), who then purchased the property as the highest bidder at the trustee sale. WDP, WWH, and Equity all filed for summary judgment to quiet title to the mall. CSI cross-moved for summary judgment seeking to establish its liens as having a higher priority than the deeds of trust. Two days before the summary judgment hearing, CSI filed a pleading called an "Omnibus Final Pleading." The three respondents successfully moved at oral argument to strike the document as untimely. The trial court denied CSI's motion for summary judgment and granted the cross-

LIEN CLAIMS/NECESSITY OF "IMPROVEMENT" TO REAL PROPERTY/ NECESSITY OF CONTRACT/DEEDS OF TRUST AND NON-JUDICIAL FORECLOSURE PROCEEDINGS v. LIEN FORECLOSURE PROCEEDINGS from previous page

motions for summary judgment filed by WDP, WWH, and Equity. The trial court also granted an immediate appeal to the Court of Appeals.

Issues on Appeal

"Omnibus Pleading." It is entirely unknown from the Court's opinion what exactly was contained in the "Omnibus Pleading," which CSI was attempting to introduce at the summary judgment proceedings. Whatever it was, neither the trial court nor the Court of Appeals seemed to be very interested in looking at it. On appeal, CSI's legal counsel argued that "excusable neglect" justified the late filing. The Court of Appeals made short work of the excusable neglect argument by simply indicating the trial court has discretion as to whether to accept untimely documents and the court also has the authority to enlarge time deadlines where the request is made before the time period has expired. However, the Court of Appeals held that once a deadline passes, the court can accept late filings only if a motion is filed explaining why the failure to act was due to excusable neglect. It appears from the Court of Appeals' decision that CSI supposedly did not file any motion to establish excusable neglect at the trial court. According to the Court of Appeals, "it is impossible for a trial court to abuse discretion it was never called upon to exercise."

2) Summary Judgment Regarding Lien Priority. The pivotal issue in the case was the lien priority versus deed of trust priority issue. This issue essentially turned upon the test pit drilling work performed on August 7, 2007 (which was the only date that predated the recording dates of the two deeds of trust). The respondents (WWH, BMP and WDP) claimed that the drilling work failed to satisfy several different requirements of the lien statute.

Liens must be filed within 90 days of the lien claimant's final provision of labor or materials or services to the project. There was no issue apparently raised regarding this requirement. If the lien was timely filed (within 90 days of the last labor or services or materials furnished by the lien claimant), then the lien relates back to the date that the lien claimant <u>first began</u> furnishing labor or materials or equipment to the project. A mortgage or a deed of trust, on the other hand, attaches to the property (for priority purposes) from the date that it is recorded.

In this particular case, the deeds of trust were recorded in early February 2008, and the test pits were dug by CSI's subcontractor in August of 2007. Other site work did not begin by CSI until apparently February 28, 2008. Thus, it was critical for CSI to establish that its lien related back to the initial test pit work. The three respondents attacked

the test pit work on several grounds. First, they argued that the test pits did not constitute an "improvement" of real property. Secondly, they argued that the test pit work was not done pursuant to a contract, and third, it was not work provided at the request of the owner or the owner's agent. The Court of Appeals agreed with the trial court on all three (3) bases.

a) The "Improvement to Real Property" Requirement. Basically, the Court found that the test pits did not fit the definition of an "improvement" to real property because they would not be permanently affixed as a part of the realty. Under the definition of improvement in section 60.04.011(5), the Court indicated that subsections (a) and (b) of 60.04.011(5) strongly suggest that the resulting improvements must be permanently affixed to or become a part of the realty. One of the cases cited by the appellate court was one of removal of contaminated soil from the realty, which was previously held non-lienable. Performing development services (such as obtaining required permits) also does not amount to an improvement.

The Court also dismissed subsection (c) of the improvement definition statute dealing with professional services upon real property in preparation for or in conjunction with the activities constituting permanent improvement. The Court of Appeals indicated that the court was required to strictly construe the lien statute, and in a footnote pointed out that even if it did constitute a professional service in preparation for other lienable activities, there is a separate statute 60.04.031 which basically requires that professional services that do not improve the land requires a separate written notice of the services be made within 60 days of the activity for which payment is sought.

The Court's interpretation of what constitutes an "improvement of real property" seems to be overly restrictive and, in particular, it seems to consider the definition language in the same definition section of the statute which defines an improvement of the land to include "altering" of any real property. It is hard to conceive a broader term, and seems to be contrary to the Court's statement that the "activities described in subsections (a) and (b) strongly suggest[ing] that the improvements must be permanently affixed to or become part of the realty." Indeed, the same definition language the Court is relying upon defines an improvement as including "demolishing." Yet, the Court, in part, relies upon the earlier Court of Appeals Division 2 case which held that removal of contaminated soil from realty, as not being an improvement to real property. [TPSG Soil Recyclers of Washington v. WF Anderson Constr., 91 Wn. App. 297 (1998)]. However, the Division 2 case seems equally puzzling in its analysis of what constitutes an "improvement" to real property.

b) The Requirement of Work or Materials Being Furnished Under a "Contract." The Court of Appeals continued on next page

LIEN CLAIMS/NECESSITY OF "IMPROVEMENT" TO REAL PROPERTY/ NECESSITY OF CONTRACT/DEEDS OF TRUST AND NON-JUDICIAL FORECLOSURE PROCEEDINGS v. LIEN FORECLOSURE PROCEEDINGS from previous page

held further that CSI's lien also "failed the contract requirement." This also seems potentially troubling because the Court relies upon the language of the statute which said the lien shall be for "the contract price," which language the Court held "implied" that a contract must be in place when the work is performed. "Contract price" is defined in the definitions section of the lien statute [60.04.011] as meaning "the amount agreed upon by the contracting parties, or if no amount is agreed upon, then the customary and reasonable charge therefor." One can certainly conceive of circumstances in which a homeowner or someone deemed to be an agent of the owner hires a laborer to perform certain repair work on a residential structure without benefit of entering into a contract prior to performing the repair work. If the requirement of a contract includes an implied in fact or implied in law contract, then there's not necessarily a problem. However, if the Court is suggesting that there must be a formal contract agreement in place prior to performing the work, it seems like there is a potential problem. In any event, Division 3 has gone on record as holding that there is a requirement of a "contract" in order for there to be a lien.

- c) The Requirement that the Work Be Performed at the Request of the Owner or His Authorized Agent. Just to complete the trifecta of invalidating CSI's liens, the digging of test holes by CSI's subcontractor was also held to be non-lienable because it was not performed at the request of the owner of the property or the owner's authorized agent. Basically, the Court held that while the test holes were dug with knowledge, and arguably at the request of WDP, WDP was neither the owner nor agent of the contractor or of the owner of the property at that time. Rather, WDP was merely a potential suitor for the owner's property.
- d) Deeds of Trust Sale. CSI also raised an issue on appeal that the deeds of trust sale were procedurally defective for several reasons. The Court of Appeals quickly brushed this argument aside, indicating that this was basically a collateral challenge to the deed of trust non-judicial foreclosure which was waived by CSI not objecting. In the Court's words, "the short answer to this challenge is that CSI made no effort to stop the trustee sale before the fact, nor did it act to set the sale aside once the alleged defects became known." The Court further indicated that CSI believed its liens were superior to deeds of trust, but did not take action to stay the trustee sale. Instead, CSI proceeded with its own foreclosure action. In so doing, the Court held that any challenge to the trustee sale was waived by CSI for failing to properly set aside the sale.

Contractor Registration Act/Substituted Service Provision 18.27.040(3)/Failure of Plaintiff to Personally Serve Contractor/ Failure of Plaintiff to Obtain Personal Jurisdiction over Contractor/Default Judgment Against Contractor Partially Vacated

by Casey L. Lund – Winston & Cashatt – Spokane, Washington

In the case of *Ahten v. Barnes*, 242 P.3d 35 (2010), Division I of the Court of Appeals issued an opinion which underscores the **limitations of the substitute service provision** 18.27.040(3) and the importance of obtaining personal jurisdiction over a contractor in instances where a party intends to obtain and enforce a judgment in excess of the bond or deposit to which they are entitled under RCW 18.27 *et seq.* Where a homeowner plaintiff brings [1] a claim against a contractor, and [2] a claim against a contractor and the contractor's surety, but <u>only</u> serves the Department under the *Contractor's Registration* statute, the maximum exposure of the contractor and the contractor's surety is the penal amount of the bond.

June 18, 2008: Ahten, a homeowner, filed a breach of contract suit in King County Superior Court against a general contractor, Barnes, and against Barnes' surety, Western Surety Company. Pursuant to 18.27.040(3) the summons and complaint were served on the Department. The Department then copied Ahten on the June 24, 2008, transmittal letter it sent to Western Surety and Barnes — proof that the summons and complaint had been sent to both named defendants via certified mail. Believing the service adequate, Ahten did not personally serve Barnes with the summons and complaint. Barnes did not appear or answer the complaint.

September 4, 2008: Ahten filed (and was granted) a motion for default judgment in the amount of \$250,496 plus attorneys' fees and costs of \$335. Ahten contended that Barnes had been properly served pursuant to 18.27.040(3), attaching a copy of the Department's June 24, 2008, transmittal letter to its motion. After the default judgment was granted, Western Surety paid Ahten the full amount of the bond, \$12,000.1

August 25, 2009: Barnes filed a motion to set aside the default judgment, asking the court to [1] vacate the order and judgment, [2] declare the judgment void for lack of service on Barnes, [3] require Ahten to return the \$12,000 it had received from Western Surety, and [4] award Barnes fees and costs.

Contractor Registration Act/Substituted Service Provision 18.27.040(3)/Failure of Plaintiff to Personally Serve Contractor/Failure of Plaintiff to Obtain Personal Jurisdiction over Contractor/Default Judgment Against Contractor Partially Vacated from previous page

On September 1, 2009, Judge Brian Gain, having heard oral argument, took the motion under advisement. On October 2, 2009, Judge Gain issued his opinion. Barnes' motion as to the portion of the judgment paid by Western Surety (\$12,000) was denied — Ahten did not have to refund the \$12,000 it was previously paid. However, Barnes' motion as to the remaining portion of the judgment (\$238,831) was granted — Ahten's original \$250,831 judgment had effectively been reduced to the penal amount of the bond, \$12,000. Having partially granted and partially denied the motion, the trial court chose not to award either party attorneys' fees or costs.

Judge Gain stated in his ruling: "having heard a motion to vacate default judgment, And the Court having researched the legislative history of Substitute Bill 5101 passed in 2001 and substitute House Bill 1843 passed in 2007 ... there was no intent by the legislature to confer personal jurisdiction on the contractor by service on the department except for actions against the bond or deposit of the contractor"

October 27, 2010: Ahten filed her notice of appeal with Division I, hoping to resurrect the \$238,831 portion of the judgment vacated by the trial court's ruling. Ahten argued [1] that a plain reading of 18.27.040(3) did not require personal service of the summons and complaint on the contractor; [2] that the trial court had not correctly interpreted the legislative intent of House Bill 1843 passed in 2007; [3] that since the statute was unambiguous it was error for the trial court to have relied on legislative history.

The appellate court reviewed the trial court's granting of Barnes' CR 60(b) motion *de novo*, and succinctly explained their reasoning for agreeing with the trial court as to vacating the \$238,831 portion of the judgment. First, there must be proper service to achieve personal jurisdiction over a party. Second, a default judgment is void if there is not proper personal jurisdiction. Third, a motion to vacate a void default judgment may be brought at any time after the judgment has been entered.

Although the appellate court did not specifically state that the statute was ambiguous, it did proceed to walk through its own statutory interpretation of 18.27.040, effectively ratifying the trial court's decision to engage in its own analysis of legislative history.

Additionally, on its path towards affirming the trial court's ruling, the appellate court cited three previous Washington cases which dealt with RCW 18.27: Mid-City Materials, Inc. v. Heater Beaters Custom Fireplaces, 36 Wn. App. 480 (1984), Subcontractors and Suppliers Collection Services v. McConnachie, 106 Wn. App. 738 (2001), and Cosmopolitan Engineering Group, Inc. v. Ondego Degremont, Inc.,

159 Wn.2d 292 (2006). Ahten did not ignore the history of applicable case law; instead, Ahten argued that the 2007 amendment to 18.27.040 had overruled *Mid-City*, *McConnachie*, and *Cosmopolitan*. The court opined that there was no indication in the legislative history to suggest that the legislature intended to amend the statute to overrule prior judicial decisions. Additionally, the court believed that if the legislature had intended 18.27.040(3) to apply to suits against contractors, in addition to suits against contractors and their bonds, then the legislature would clearly have stated as much.

Prior to 2007 the pertinent part of 18.27.040(3) read: "Service of process in an action against the contractor, the contractor's bond, or the deposit shall be exclusively by service upon the department" After the legislature's 2007 changes were implemented, the aforementioned provision was modified to read: "Service of process in an action filed under this chapter against the **contractor and the contractor's bond** or the deposit shall be exclusively by service on the department" The court in Ahten held that the provision applied to RCW 18.27 actions against a **contractor and contractor's bond**; however, the provision did not apply to actions filed outside of 18.27. The court was unconvinced that the statute had called into question earlier decisions, and the court even opined that the legislature's intent in the 2007 provision was "even more clear."

The appellate court then briefly touched on Barnes' original request for an award of attorneys' fees from the trial court in Barnes' original motion to set aside the default judgment. The appellate court did not allow Barnes' attorneys' fees because the void portion of the claim at issue (\$238,831) did not fall under 18.27, and Barnes had not prevailed on overturning the \$12,000 judgment awarded to Ahten under 18.27. RCW 18.27 applied only to the \$12,000 portion of the original \$250,831 judgment, thus, Barnes was not entitled by statute to recover attorneys' fees.

The \$238,831 lesson learned from *Ahten*: Ahten incorrectly believed that she had obtained personal jurisdiction over Barnes, pursuant to 18.27.040(3), for the entire \$250,831 judgment. However, the substitute service provision of 18.27 applies <u>only</u> to those claims which can be mutually asserted against the contractor and the bond or deposit of the contractor; Ahten did not realize that service on the Department did not confer personal jurisdiction on the contractor beyond the maximum awardable damages as limited by 18.27.040(6). Only the first \$12,000 of Ahten's claim could be mutually asserted against the contractor and the contractor's bond. As such, Ahten's recovery was limited by statute to \$12,000.

¹ Barnes contends that the surety did not investigate or personally contact him prior to disbursal of the funds. Additionally, it is alleged that Barnes was residing out-of-state when the Department mailed the summons and complaint to him. Both of these allegations are not significant to the outcome.

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